European Stability Mechanism

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# Proposal by the Managing Director for a Financial Assistance Facility Agreement (FFA) with the Hellenic Republic

## 1. Background

On 8 July 2015, the Hellenic Republic ('Greece') made an official request for stability support from the ESM - in the form of a loan facility - to the Chairperson of the Board of Governors (BoG), to be used for meeting debt obligations and to ensure stability of its financial system. A separate request for financial assistance was sent to the International Monetary Fund (IMF) on 23 July 2015.

Following the receipt of the aforementioned request, and pursuant to Article 13(1) of the ESM Treaty in conjunction with Article 2 of the ESM Guideline on Loans, on 8 July the Chairperson of the ESM Board of Governors entrusted the European Commission (EC), in liaison with the European Central Bank (ECB), with the following tasks:

- to assess the existence of a risk to the financial stability of the Euro area as a whole or of its Member States;
- to assess, together with the IMF, whether the public debt of Greece is sustainable; and
- to assess the actual or potential financing needs of Greece

On the basis of both the adoption by the Greek Parliament of all the commitments specified in the Euro Summit statement of 12 July 2015 and the above-mentioned assessments, the ESM Board of Governors decided on 17 July 2015, pursuant to the proposal by the ESM Managing Director of 14 July 2015, to grant, in principle, stability support to Greece in the form of a loan in accordance with Article 13(2) TESM. In addition, the ESM Board of Governors, in accordance with Article 2(3)(b) of the Guideline on Loans, entrusted the Managing Director with the task of preparing a proposal for an FFA and, according to Article 13(3) of the Treaty, the EC – in liaison with the ECB and together with the IMF – with the task of negotiating a MoU with Greece, detailing the policy conditions attached to the loan.

## 2. Summary of the Memorandum of Understanding specifying policy conditionality underpinning the financial assistance.

According to Article 13(3) TESM, the financial assistance facility is subject to policy conditionality detailed in the MoU. The content of the MoU shall reflect the severity of the weaknesses to be addressed and the financial assistance instrument chosen. The MoU prepared by the Commission, in liaison with the ECB, provides for such conditions.

On 11 August 2015, the Greek authorities and the institutions reached a staff level agreement on the policy conditionality underlying the future macroeconomic adjustment programme for the period 2015-2018. The formal signing of the MoU by all parties is envisaged for 19 August 2015. The policy package aims to restore fiscal sustainability,

safeguard financial stability, boost growth, competitiveness and investment and reform the public administration.

To achieve these goals, the macroeconomic adjustment programme builds on four pillars. First, a combination of upfront parametric fiscal reforms and an ambitious agenda aimed at strengthening tax compliance and public financial management, restoring fiscal sustainability and ensuring the adequate protection of vulnerable groups. Some reforms (e.g. VAT and elements of the pension system) have been already legislated as part of the prior actions preceding the MoU negotiations. A further significant fiscal package, expected to yield about 4% in savings by 2018, is to be adopted as prior action for the first disbursement, as well as for the completion of the first review. These and additional measures to be identified and legislated in October, will underpin the achievement of a primary surplus of 3.5% of GDP by 2018.

Second, effective Non-Performing Loans (NPLs) management and the recapitalisation of banks will ensure financial stability. The Single Supervisory Mechanism (SSM) will conduct an Asset Quality Review (AQR) and a stress test to determine the necessary recapitalisation envelope. Furthermore, additional measures will strengthen the governance of the Hellenic Financial Stability Fund (HFSF) and of banks.

Third, a structural reform agenda will remove obstacles to the smooth functioning of labour and product markets and ensure full compliance with EU requirements, while aiming to achieve European best practice. An ambitious privatisation programme and adoption of policies that support investment will boost competitiveness and facilitate sustainable and balanced economic growth.

Finally, increasing the efficiency of public administration in the delivery of essential public goods and services is a key priority of the programme. The measures will target corruption, enhance the efficiency of the judicial system and strengthen the independence and operational independence of key institutions such as revenue administration and the statistics institute (ELSTAT).

For the duration of the ESM programme, the Greek authorities are committed to take all the necessary measures to ensure compliance with the conditionality specified in the MoU.

Disbursements under the financial assistance facility agreement will be conditional on such compliance.

## 3. Financing needs

The ESM Board of Governors decided, on 17 July 2015, to grant – in principle – financial assistance to Greece amounting to up to €86 billion in order to safeguard financial stability in Greece and the euro area as a whole.

The Institutions estimate Greece's net financing needs at around €86 billion over the three-year programme horizon, i.e. August 2015-August 2018. This includes needs for the recapitalisation of the banking sector (up to €25 billion), medium- and long-term debt service including loans (approximately €54 billion), and around €15 billion for arrears clearance and

built-up of cash buffers. €2 billion from primary surplus and €6 billion from privatisation proceeds are also accounted for. This programme envelope, which rests on plausible growth and fiscal assumptions, includes buffers in case of worse–than–expected macroeconomic and financial sector outcomes. Final confirmation of the financing needs for bank recapitalisation and bank resolution costs will follow the SSM's assessment. Based on the information above, the financial envelope determined by the Board of Governors on 17 July 2015 remains appropriate at this juncture.

The IMF has publicly announced that it will fully engage in a programme negotiation after having determined the capacity and willingness of the Greek authorities to deliver the required adjustment and following the adoption of debt relief measures by the European creditors. Since these measures are conditional on a successful first review of the ESM programme, the IMF contribution to the financial assistance is at this stage undetermined. The ESM's envisaged maximum envelope of €86 billion will be reduced when the amount of IMF financing is decided. This envelope might be also reduced if the privatisation proceeds are higher and market access secured at reasonable cost and at an early stage.

**4. Proposal for a Financial Assistance Facility Agreement**

According to Article 13(3) TESM, the Managing Director of the ESM shall prepare a proposal for an FFA, including the financial terms and conditions and the choice of instruments, to be adopted by the Board of Governors.

In view of the above, it is proposed to provide an FFA to Greece on the following terms:

1. The financial assistance is granted in the form of a loan facility based on the '*Loan Facility: Facility Specific Terms*' in Section 1 of the ESM Facility Specific Terms for ESM Financial Assistance Facility Agreements. Given that a portion of such assistance will be used to cover recapitalisation/resolution needs of financial institutions, provisions from other Sections of the ESM Facility Specific Terms will apply to such assistance.

2. The total financial assistance and loan facility amount will be up to €86 billion, pending determination of IMF's contribution as stated above, and may be used for general financing needs of the public sector as well as to cover bank recapitalisation and resolution costs. The definitive and final financial assistance and loan facility amount to be provided by the ESM will be separately documented between the contracting parties once IMF's contribution is known.

3. The loans provided to Greece will have a maximum weighted average maturity of 32.5 years.

4. The latest date by which the financial assistance may be made available to Greece will be 20 August 2018.

5. The Margin charged to Greece for the loans disbursed will be 10 basis points as stipulated in the ESM Pricing Policy.

6. An Up-front Service Fee of 50 bps will be paid upfront by Greece for every disbursement following the receipt of an invoice sent by ESM in accordance with the ESM Pricing Policy, or directly deducted from a cash disbursement.

7. An Annual Service Fee of 0.5 bps will accrue day to day, to be paid in arrears with effect from the first interest payment date of each tranche, as part of the ESM Cost of Funding. It will follow the interest payment schedule.

8. A Commitment Fee, allocated to Greece in accordance with the Diversified Funding Strategy and applied in line with the applicable guidelines, will be payable each year following the receipt of an invoice at the beginning of each following calendar year, as part of the ESM Cost of Funding.

9. The repayment profile for a disbursement will be bullet or amortising, as may be defined in the relevant Confirmation Notice.

10. A subsection of the FFA varies, supplements or replaces the ESM General Terms and the ESM Facility Specific Terms on the following matters:

    a. It supplements the lending documents' undertaking provisions so as to provide comfort to the ESM that:

        - It has the right to appoint an observer in HFSF,
        - HFSF will grant upfront security over the capital instruments acquired under a recapitalisation operation. In addition Greece undertakes to maintain a legal framework enabling HFSF to perform its security and undertaking obligations towards ESM.
        - HFSF undertakes to pursue its rights in relation to its shareholdings in the recapitalised institutions,
        - If a resolution operation is funded through an on lending operation from HFSF to TEKE (the Greek resolution fund), HFSF will grant security over the loan agreement with TEKE,
        - The Privatisation Fund to be established in Greece (and with the characteristics envisaged under the Euro summit agreement) will consent to becoming a party to the lending arrangements in order to include repayment mechanisms as set out in the Euro summit statement,

    b. The agreement develops Greece's and HFSF's information undertakings in relation to recapitalisation operations and recapitalised banks, and includes information undertakings to support HFSF's obligations in relation to any potential on-lending to TEKE and board observer status for the ESM,

    c. The agreement complements the Events of Default section to include cross-default provisions in relation to the PSI and the GLF.

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